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IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

GEOFFREY, INC.,
Petitioner,

v.

SOUTH CAROLINA DEPARTMENT OF
REVENUE AND TAXATION,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of South Carolina

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BRIEF OF THE COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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INTRODUCTORY STATEMENT

This brief is submitted by the Committee on State Taxation as *amicus curiae* in support of the petitioner in the above-captioned matter. Written consents of the petitioner and respondent have been obtained and filed with the Clerk of the Court.

INTEREST OF *AMICUS CURIAE*

The Committee on State Taxation ("COST") is a non-profit association that was organized in 1969 as an advisory committee to the Council of State Chambers of Commerce. COST, which was separately incorporated on January 1, 1992, has a membership of more than 400 major multistate corporations, engaged in interstate and international business. COST's objective is to preserve

and promote equitable and non-discriminatory state and local taxation of multijurisdictional business entities.

Many of COST's member companies are engaged in business in the State of South Carolina, as well as in other states now asserting the *Geoffrey* theory of economic presence as nexus for purposes of income tax jurisdiction. The impact of the *Geoffrey* decision and the reach of state nexus statutes based on economic presence is much broader than immediately apparent. Most taxpayers are sensitive to and careful in following established nexus rules and Public Law 86-272. Where radical departures from accepted notions of nexus are permitted to occur on an *ad hoc* basis, as in this case, taxpayers that previously understood their compliance responsibilities are left without guidance, and their ability to comply with state tax laws is severely impaired. Therefore, COST has an interest in the instant case.

SUMMARY OF ARGUMENT

This Court has set a bright-line test of physical presence as a predicate for states exercising their taxing jurisdiction. *Quill Corporation v. North Dakota*, 112 S. Ct. 1904 (1992). States can adopt and utilize a variety of statutory tools to enforce their jurisdiction against any entity whose physical presence has been established. Absent this requisite connection to the taxing jurisdiction, the state may not employ any of those tools to impose a tax liability against an entity. Further, the states are not free to ignore the available statutory tools nor may they choose not to use them for the perceived expediency of taxing non-nexus entities; the very expediency that is attractive to South Carolina is based upon a violation of the Constitution.

The Commerce Clause places a premium on the maintenance of a degree of certainty in commerce. It requires that states (1) adhere to the constitutional principles under which they exercise their sovereign rights to tax, and (2) utilize only taxing methods and tools that have

been legislatively or judicially crafted. It does not permit the interstate chaos generated by the selection of tax targets without physical presence in the taxing state.

ARGUMENT

I. STATUTORY TOOLS ARE AVAILABLE TO THE STATE TO ENFORCE ITS TAXING JURISDICTION WITHIN THE "BRIGHT LINES" DRAWN BY *QUILL*, THEREFORE UNPRINCIPLED EXTENSIONS OF THAT JURISDICTION SHOULD NOT BE TOLERATED.

In *Quill Corp. v. North Dakota*, 112 S. Ct. 1904, 1916 (1992), this Court established a "bright-line" nexus test, based upon physical presence. This standard is consistent with the Court's other nexus holdings and is not inconsistent with the technologically advanced state of commerce. The bright-line physical presence requirement also satisfies the specific concerns underlying the Commerce Clause (establishing boundaries of legitimate state authority, reducing litigation, and encouraging settled taxpayer expectations). *See Quill*, 122 S. Ct. at 1915-16. None of this Court's nexus jurisprudence, including the recent *Quill* case (a use tax nexus case) and previous income tax nexus cases, provides support for the South Carolina Supreme Court's radical conclusion that the "minimum contacts" and "substantial nexus" required in order to be subject to a state's income tax can be established without some physical presence in that state. Nexus based upon mere economic presence does not exist, nor is the creation of such a standard justified.

South Carolina, like every other State, has a number of statutory and judicially crafted tools for the purpose of enforcing its constitutional taxing jurisdiction and applying specific tax provisions to a taxpayer that is subject to its jurisdiction. Among these tools are: (i) the arbitrary shifting of income doctrine, whereby the State readjusts intercompany transaction prices, so as to address

non-fair market value charges for goods and services, and other practices by which the net income of one corporation has been arbitrarily shifted to one or more other corporations in a group under substantially common control; (ii) the step transaction doctrine, whereby the State collapses several sequential transactions between two or more substantive entities that are designed to either avoid or reassign to another party the tax consequences that the collapsed single-step transaction would have engendered; and (iii) the sham transaction doctrine, whereby the income of a non-taxpayer corporation that the State demonstrates to be a "paper corporation" is flowed through to the substantive South Carolina taxpayer whose activities in reality generated that income.

Aside from the existing statutory tools that the State resolutely ignores, South Carolina could at any time—without crossing *Quill*'s bright line and asserting jurisdiction over an entity lacking physical presence in the State—legislatively adopt other powerful tools that would legitimately enable it to tax the transaction between Toys R Us and its affiliate Geoffrey. The South Carolina legislature could adopt the domestic combination method of reporting. Under this method, Toys R Us—the unitary affiliate with South Carolina nexus—would be required to file a combined return in the state; while the mechanics of the formula are somewhat complex, the effect would be to include in the apportionable tax base of Toys R Us all income realized by its unitary affiliate Geoffrey on its trademark licensing activities.[1] This method of taxing

[1] The combined apportionment formula would include in the denominators of its apportionment fractions the payroll, property and sales of Geoffrey. The effective increase in tax liability of Toys R Us that results when Toys R Us is required to file a combined return is generated by the elimination of all intercompany transactions from the return; to the extent that Geoffrey's licensing royalties are attributed to members of the combined group, they are eliminated, but so too is the deduction Toys R Us had received on a separate return with respect to license fee payments made to Geoffrey.

Toys R Us would satisfy the constitutional principles that are violated by South Carolina's assertion of economic presence jurisdiction over Geoffrey.

For a variety of political reasons, states choose differing methods of taxation and enforcement tools; but in every case, the implementation of a chosen method or tool must be even-handed, *i.e.*, the State must apply and enforce the method without regard to whether it results in a tax reduction or increase to specific taxpayers. It may be that the tools that a State has adopted do not reach a specific form of income or a specific taxpayer, or are not easy to employ in a given situation; nevertheless, the State cannot create or implement an *ad hoc* theory that abandons established principles of nexus. Such abandonment introduces a high degree of uncertainty in an area where the taxpayer is expected, at least initially, to make an accurate determination of its tax liability.

II. *GEOFFERY* INTERJECTS UNCERTAINTY FOR TAXPAYERS THAT DO NOT DO BUSINESS OR HAVE PHYSICAL PRESENCE IN A GIVEN STATE.

The stakes in *Geoffrey* are much more significant than the limited facts of the case indicate. Other states have actually moved to assert income tax jurisdiction over corporations with no physical presence in their states. A survey of COST's member corporations has yielded many potential applications and extensions of the *Geoffrey* nexus doctrine which will impact almost every segment of American industry and business. The several examples below, like those presented by Geoffrey, *see Petition* pp. 9 and 20, illustrate the uncertainty that results where states reject their legislated tools (many of which adequately address the factual scenarios presented) in favor of a *Geoffrey* economic presence approach:

(1) Public Law 86-272: A very basic and unsettling question raised by the decision below is whether a brand

name product manufacturer may in every instance be subject to income taxation by a *Geoffrey* state, even where it is otherwise clearly protected by Public Law 86-272.[2] A state could in the name of *Geoffrey* assert that an intangible property interest of the manufacturer—goodwill—is created in that state in every instance where the manufacturer's brand name products compete against generic products. A favorable selling price differential for a branded product may generate income to the manufacturer. Because the brand name was intentionally placed in the state market, the question arises whether the manufacturer could be taxed on the portion of its income attributable to goodwill, this despite the fact that Congress has explicitly stated that persons complying with the limitations on their in-state activities set forth in Public Law 86-272 would be protected from income taxation by a state. The next question is whether, once *Geoffrey* economic presence nexus is established, a state will go one step further and assert the right to tax *all* income of such a company, contrary to the dictates of Public Law 86-272, on the grounds either that *Geoffrey* economic presence nexus is an independent basis for asserting its tax jurisdiction, or that the company is engaged in more than mere solicitation in the state, by way of its "economic presence" there.

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[2] 73 Stat. 555, 15 U.S.C. sec. 381. Public Law 86-272 protects any person engaged in interstate commerce from income taxation by a State if the person's only activities in that State are either or both of the following: "(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the state for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1)." *See, e.g., Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*, 112 S. Ct. 2447 (1992).

(2) Patent royalties: Where a patent holder doing business only in State X licenses a manufacturer in State A, the licensee manufacturer in State A could receive income from the sale lease of patented articles in State A, which are removed by the purchaser to State B. That transaction generates royalty income to the licensor. Under *Geoffrey*, it would appear that this generation of income creates nexus to tax the licensor in State A. However, if none of the patented articles are sold in State A, is the licensor nonetheless taxable in State A? Questions persist regarding the implementation of this doctrine: Is the patent licensor likewise liable for income tax in State B (and every other state to which patented articles are removed)? If the patented articles are also sold in State B, is the licensor liable for income tax in that state?

(3) Broadcast nexus: Several states have indicated their potential interest in assessing income tax against every NFL and other professional sports team whose games are televised within a state, even if no games are ever played within the taxing state by such teams. In such a case, the licensee's broadcast of the game in any state apparently will be deemed to trigger jurisdiction over the licensor based upon the intangible right that generates income to the team. However, does a *Geoffrey* analysis apply if the broadcast license fee is predetermined and does not depend on any state's viewership figures, or upon revenue raised by the broadcaster from advertisers in that state?

If the *Geoffrey* economic presence theory is left intact, taxpayers will be unable to determine whether they have nexus with a particular state for tax purposes. Even if the legislated tools adopted by a state do not apply to a taxpayer under the bright-line test of *Quill*, the States will feel free to ignore this Court's nexus jurisprudence in a manner designed to avoid the legislative process and to reach taxpayers or income on an unprincipled, case-by-case basis.

CONCLUSION

For the reasons set forth above, the Committee on State Taxation respectfully requests that petitioner's petition for writ of certiorari be granted.

Respectfully submitted,

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